No. 10274

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

SEATTLE RENTON LUMBER COMPANY,
a corporation,

Appellant

vs.

UNITED STATES OF AMERICA,

Appellee

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON NORTHERN DIVISION

HONORABLE LLOYD L. BLACK, *Judge*

BRIEF FOR THE APPELLEE

J. CHARLES DENNIS,
United States Attorney.

THOMAS R. WINTER,
Special Assistant to the Chief Counsel.

SAMUEL O. CLARK, JR.,
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BRIEF FOR THE APPELLEE

OPINION BELOW

The District Court did not render a written opinion in this case; its oral decision will be found at pages 17 - 36 of the Record.

JURISDICTION

This appeal involves income and excess profits

tax deficiency assessments made by the Commissioner of Internal Revenue against taxpayer, a Washington corporation, in the principal amounts of $2,772.90 and $874.39, respectively, for the calendar year 1933, which amounts, together with interest thereon were paid by taxpayer to the Collector of Internal Revenue at Tacoma, Washington, on May 11, 1936. (R. 4, 37-38.) Claim for refund therefor (R. 4-9) filed November 6, 1936, was rejected by the Commissioner, taxpayer being notified of such rejection by letter dated April 9, 1937 (R. 38-39).

On March 12, 1938, taxpayer instituted an action for recovery of taxes paid against the United States under the provisions of Section 24, Twentieth, of the Judicial Code as amended, in the District Court for the Western District of Washington, Northern Division. (R. 2-11) The judgment of the court denying the claim was entered August 20, 1941. (R. 42-43) Taxpayer's motion for new trial filed August 27, 1941, was denied July 13, 1942. (R. 34-36.) Within three months and on August 25, 1942, taxpayer filed notice of appeal to this Court pursuant to the provisions of Section 128(a) of the Judicial Code as amended. (R. 43-44.)

QUESTION PRESENTED

Whether under the circumstances of this case the income realized from operation of the business subsequent to June 30, 1933, was properly taxable to taxpayer corporation as a part of its income for the 1933 calendar year.

STATUTE INVOLVED

Revenue Act of 1932, c. 209, 47 Stat. 169:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
>
> * * * * *

STATEMENT

The facts as here stated are summarized from the findings and oral decision of the District Court (R. 17-34, 37-40), from admitted allegations of the pleadings (R. 2-16), and from evidence adduced by

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[1] Including Government's cross examination of taxpayer's witnesses.

taxpayer (R. 50-167)[1] which was not controverted.

Taxpayer is a Washington corporation. (R.2.) It incorporated in 1929 and thereafter engaged continuously in the manufacture and sale of lumber. (R. 20.)

In 1933, the taxable year here concerned, its 900 shares of outstanding stock were held by approximately 14 stockholders. F. M. Roberts owned about 237 2/3 shares, James C. Carlson about 215, James P. Weter about 211, and C. A. Shinstrom held 100 shares. The balance of 136 shares was divided among about 10 other persons, their proportionate interests varying from one share to 37.[2] With the exception of the stock appearing in the name of James C. Carlson, some small amounts in the names of his wife and two children, and the stock held by James P. Weter, all of the stockholders were relatives by blood or marriage of F. M. Roberts. (R. 20, 104-107.) James P. Weter and F. M. Roberts were law partners. (R. 60.)

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[2] Although reference is made (R. 105) by Government counsel to the list of stockholders as of June 30, 1933 (the date of the hereinafter-mentioned alleged formation of the partnership and purported transfer to it of the corporate assets), such list was not made a part of the record and the testimony of taxpayer's witness, F. M. Roberts, does not furnish an accurate inventory of the stockholding interests (R. 104-107). The exact interest of each stockholder, however, is not material to the issue.

The board of trustees of taxpayer was composed of James C. Carlson, president and acting manager, F. M. Roberts, secretary and treasurer, and James P. Weter. (R. 20.)

Sometime in the early part of 1933 F. M. Roberts discussed with various stockholders the advisability of operating the business as a partnership instead of in corporate form, in order to reduce tax liability. (R. 21.) All of the stockholders were consulted by Mr. Roberts with the exception of Carlson's wife and two children. With the exception of Roberts' conversations with stockholder Rex Swan, the discussions were informal in character and concerned merely the purpose of the proposed change. The plan met with the approval of all of the stockholders with whom it was discussed. (R. 21-22.)

It was the practice of the corporation to take inventory at the close of business June 30 and December 31 of each year, and to take off a profit and loss statement at that time. (R. 22.)

Under date of June 15, 1933, the following notice was mailed to all of the stockholders (R. 22):

> Bryn Mawr, Washington, June 15, 1933
> To the stockholders of the Seattle-Renton Lumber Company:
>
> You are hereby notified that there will be a

special meeting of the stockholders of this corporation held at the mill office at three P. M., June 30, 1933, to pass upon the question of the sale of the assets of the corporation to a partnership to be formed to take over the same.

(Signed) R. F. M. ROBERTS, Secretary.

On June 30, 1933, taxpayer's board of trustees held a meeting, the minutes of which recite the following (R. 62-64):

> A meeting of the Trustees of the Seattle Renton Lumber Company was held at the mill office on June 30, 1933, there being present James P. Weter, James C. Carlson and F. M. Roberts. The minutes of the last meeting of the Trustees were read and approved, after which a financial statement of the corporation was presented for the consideration of the Board, the said statement appearing after these minutes in the minute book.
>
> After a discussion of this statement it was the opinion of the Trustees that the corporation should go out of business, and that the mill and business should be taken over by a partnership composed of the present stockholders. It was at first deemed advisable to turn over everything to such a partnership, but after discussion it was decided that the corporation should retain its Accounts Receivable and the following Resolution was then presented:
>
> > Resolved that the Seattle Renton Lumber Company sell to a partnership, which will be composed of the same persons who have held stock in the Seattle Renton Lumber Company and which will be known as the Seattle Renton Mill Company, all of its real estate and tangible personal property of every description at the figures the same are now carried upon the books of the cor-

poration, less the depreciation reserve; and that the offer of the said partnership to purchase upon the said terms and to assume the mortgage upon the mill plant in the sum of $20,000.00 be accepted, and that the President and Secretary of the corporation be authorized to do whatever acts are necessary to complete the said sale. Further, that at the same time said sale is consummated, a dividend be declared of the total amount realized from such sale, to-wit, $118,662.56. That of the said amount $1368.43 represents actual earnings, and will be a dividend in the proper sense of the word, and that the balance be shown as a liquidating dividend, the same being used first to liquidate the paid-in surplus, and thereafter on account of capital. That the book entries for the said sale and the declaration of the said dividend shall be as follows:

Real Estate	$ 30,000.00
Mill and equipment	101,763.64
Mack truck	5,500.00
2nd hand Mack	345.00
Ford Coupe	669.00
Boat	1,773.12
Roadway	1,701.07
Office Equipment	580.48
	142,332.31
Less depreciation reserve	20,086.92
Carried fwd.	122,245.39
Brought fwd.	$122,245.39
Lumber inventory	8,627.23
Log inventory	7,734.94
Supplies inventory	55.00
	$138,662.56

Mortgage (assumed by buyers)	20,000.00
Dividend (undivided profits).	1,368.43
Surplus (paid in)....	32,500.00
Capital	84,794.13
	$138,662.56

Passage of the Resolution was moved, seconded and unanimously carried.

Thereafter the Treasurer was instructed to pay a 5% tax upon the said dividend, and to report the same as required by law.

On motion the meeting adjourned.

F. M. ROBERTS
Secretary

The minutes of the stockholders' meeting, also held June 30, 1933, recite as follows (R. 67-68):

Bryn Mawr, Washington
June 30, 1933.

A special meeting of the shareholders of the Seattle-Renton Lumber Co. was held at the mill on the above date, the following stock being personally represented:

C. A. Shinstrom	100 shares
James C. Carlson	230 shares
F. M. Roberts	212 shares
James P. Weter	222 shares

The call for the meeting was read, and it was then stated that a quorum was present.

The Secretary then read to the stockholders the minutes of a meeting of the Trustees which had just been held, said minutes setting forth a

resolution of the Trustees under which the real estate and all tangible personal property of the mill, a corporation, was to be sold to a partnership composed of the stockholders in the mill, the partners to contribute to the new partnership the dividends received from the mill. After reading the said minutes, it was moved, seconded and carried that the action of the Trustees in selling the mill property and in the declaration of a dividend be approved. The same received the unanimous vote of all stock represented at the meeting.

On motion the meeting adjourned.

F. M. ROBERTS
Secretary

Only James C. Carlson, James P. Weter and F. M. Roberts attended either meeting. (R. 30-31.) The meetings were not held at the mill office as stipulated in the notice to stockholders and as recited in the minutes, but were held at the Seattle law office of Messrs. Weter and Roberts. (R. 23.)

At the time of the aforementioned trustees' and stockholders' meetings the following bill of sale was executed by Carlson as president and Roberts as secretary of taxpayer corporation, Seattle-Renton Lumber Company, in terms as follows (R. 23, 73-74):

Know All Men by These Presents:

That Seattle-Renton Lumber Co., a corporation the party of the first part, for and in consideration of the sum of Ninety-Eight Thousand Six Hundred Sixty-Two and 56/100 Dollars, lawful money of the United States of America to it

in hand paid by Seattle-Renton Mill Co., a partnership, the party of the second part, the receipt whereof is hereby acknowledged, does by these presents grant, bargain, sell and convey unto the said party of the second part, its successors and assigns all machinery and equipment contained in or about the mill building and premises of the grantor at Bryn Mawr, Washington, together with two Mack trucks, one Ford coupe, one power boat "Peacock", office furniture and equipment, and all lumber, logs and supplies on hand at the said mill premises. The intention of this bill of sale is to pass title to all tangible personal property of the vendor, but including no intangible personal property of any nature or description.

To Have and to Hold the same to the said party of the second part, its successors and assigns forever. And the said grantor does for its successors and assigns, covenant and agree to and with the said party of the second part, its successors and assigns, to warrant and defend the sale of the said property, goods and chattels hereby made unto the said party of the second part, its successors and assigns, against all and every person and persons whomsoever lawfully claiming or to claim the same.

In Witness Whereof, we have hereunto set our hands and seals the 30th day of June in the year of our Lord one thousand nine hundred and thirty-three.

Signed, Sealed and Delivered in Presence of
[Seal] SEATTLE-RENTON LUMBER CO.
[Seal] By JAS. C. CARLSON
Pres.
[Seal] And By F. M. ROBERTS
Sec.

[Acknowledgement omitted.]

The corporation's accounts receivable were not included in the transfer. (R. 65-66.)

On the same day a warranty deed to the real estate on which the mill was located was executed to F. M. Roberts. It recited that it was made "in consideration of $40,000, of which $20,000 is by the assumption of the hereinafter described mortgage." The deed, like the bill of sale, was signed by Carlson as president and Roberts as secretary of the corporation. Except as above stated, the deed did not mention or describe any mortgage. (R. 23-24, 69-71.)

Roberts executed a declaration of trust the same day (R. 24) which read as follows (R. 76-79):

> I, F. M. Roberts, do hereby acknowledge that I have this day received a conveyance from the Seattle-Renton Lumber Co. of the following described real estate situated in King County, Washington, to-wit:
>
> > Block "B" of Lake Washington Shore Lands as modified in Cause No. 156371 of the Superior Court of King County, in the County of King, State of Washington; Also
> >
> > Beginning at the intersection of the Easterly line of the Seattle Renton and Southern Right of Way with a line 2 feet South of North line of Lot 1 in Block 27 of Bryn Mawr, in the County of King, State of Washington, as per map thereof recorded in Volume 5 of Plats, page 58, in the office of the County Auditor of said County; thence

Southeasterly along said Easterly line of Seattle-Renton and Southern Right of Way to the intersection of the Southerly line of of Juniper Street (Keats Avenue) as shown on said plat (now vacated); thence East along the South line of said street to the West margin of Black River Waterway as established in Cause No. 156371 of the Superior Court of King County, Washington; thence North 2° 40′ 09.5″ East along the West margin of said waterway to a point South 88° 27′ 28″ East of the point of beginning; thence North 88° 27′ 28″ West to the point of beginning.

I further acknowledge that I received said conveyance in trust for the following named persons in the following proportions:

James C. Carlson	230/900
James P. Weter	211/ "
C. A. Shinstrom	100/ "
R. C. Swan	10 "
Estelle Roberts	23 2/3 "
Helen R. Shinstrom	26 2/3 "
J. M. Roberts	19 "
Edith S. Roberts	37 "
Ruth Roberts	1 "
Mary Roberts	1 "
For Myself	237 2/3 "

I further declare that I have taken said title at the request of the persons interested in said real estate, who are partners as the Seattle Renton Mill Co., for the reason that it would be cumbersome to have the title to said real estate in the names of all of the said persons. I hereby agree to be bound by the decision of the said persons for whom I hold title in trust, as to the handling of the said title, and agree upon request to convey

the same to them, or to any other person to whom I shall be directed to make conveyance. I further declare that I have no interest in said property except only the interest as set forth in this Declaration of Trust.

In Witness Whereof, I have hereunto set my hand this 30th day of June, 1933.

[Seal] F. M. ROBERTS
[Acknowledgement omitted.]

Neither the bill of sale of the equipment nor the declaration of trust was ever filed. Both were kept by Roberts. The deed to the real property was filed for record January 2, 1936. (R. 24.)

After June 30, 1933, on signs and stationery the word "Lumber" in the company's title was changed by stamp or ink to "Mill," so that the name of the company read "Seattle-Renton Mill Company" instead of "Seattle-Renton Lumber Company." Whether Seattle-Renton Mill Company was or was not a corporation was not indicated. In the fall of 1933 10,000 checks were printed for the Seattle-Renton Mill Company, which through a mistake in printing contained blanks for the signatures of the president and secretary. The checks were used, however, despite the mistake. (R. 24-25.) An account was opened in the First National Bank of Kirkland, Washington, as of July 3, 1933, in the name of Seattle-Renton Mill Com-

pany. The signature card on this account read as follows (R. 97):

> Below please find signature (s) which you will recognize in payment of funds or the transaction of other business on my (or our) account with The First National Bank of Kirkland, Wash.
>
> Seattle-Renton Mill Co.
> Signature of By Jas. C. Carlson or By F. M. Roberts or By V. Dougherty.
>
> Address Bryn Mawr, Wn.
> Introduced by
> Date Jul. 3, 1933.
> Seattle-Renton Mill Co.

There were no written articles of partnership. There was no written or published notice of the formation of a partnership and no filing in the auditor's office of a certificate of an assumed business name. (R. 25.) Roberts had been or was at this time interested in various other business enterprises, in common with some of the stockholders of taxpayer. (R. 51, 54, 55, 56.) In several of these enterprises, including his association with Weter in the practice of law, the business was carried on as a partnership without formal articles. (R. 56-57.)

Carlson continued as manager of the mill operations, and at practically the same salary he received before 1933. Customers of the mill who telephoned as

to the reason the company name had been changed from Seattle-Renton "Lumber" to Seattle-Renton "Mill"" were told the company had become a partnership, without being told the names of the partners and without any further explanation. Except for the mortgage, the payment of the company's indebtedness was on a current basis. The Seattle-Renton Lumber Company, a corporation, continued to exist as such, paying its annual license fees to the State of Washington. (R. 25.)

In 1934 the purported partners included the earnings of the business during the last six months of 1933 in their income tax returns as their individual income. (R. 25.) Taxpayer corporation returned as corporate income only the earnings for the first six months of 1933. The Commissioner of Internal Revenue assessed a deficiency against taxpayer corporation for the year 1933 on the ground *inter alia* [3] that there was no partnership *in esse* as of July 1, 1933, and that the entire income of the year was includible in the corporate return and taxable to the corporation. (R. 168-175.)

---

[3] The correctness of deficiencies based on other grounds has been conceded by taxpayer. (R. 3.)

Taxpayer paid the amount of the assessment under protest and duly filed a claim for refund, asserting that the income in question was not taxable to the corporation (R. 4-9), and upon the rejection of the claim instituted this suit for refund. The court determined that the taxpayer operated the business on the same basis after June 30, 1933, as it did prior thereto, that there was no partnership formed by the stockholders prior to or on June 30, 1933, or at any time prior to January 1, 1934, that the steps taken to change the form of the organization for the purpose of avoiding income taxes were not sufficient to effectuate a termination of corporation ownership and operation and to supplant the corporation by a different owning and operating organization. (R. 39.) The Commissioner's action was upheld, the court stating in its opinion that taxpayer had failed to sustain the burden of proving the existence of a partnership which operated the income-producing business subsequent to June 30, 1933. (R. 17-34.)

SUMMARY OF ARGUMENT

Under the revenue laws income is normally taxable to the person who earns it, or to the owner of the property which produces it.

It is neither unlawful nor reprehensible for the owners of a business operating as a body corporate to transfer the assets and carry on thereafter as individuals, partners, or in some form other than corporate organization, with a view to reducing or avoiding liability for taxes. But such transition must be effected in fact to be effective for federal tax purposes. And where the change is actuated solely or chiefly by tax considerations its accomplishment is to be scrutinized with particular care.

The minimization of tax liability was concededly the motivating force in the case at bar; there was no business purpose. And the evidence furnishes more than substantial support for the findings of the court below that no partnership was in fact formed and no transfer in fact effected on June 30, 1933, as taxpayer claims. At best the evidence shows only that the interested parties intended to form a partnership which would take over and operate the business of the corporation. But the intention was not then consummated; and until such purpose was a *fait accompli*, the income continued taxable to the corporation. Accordingly the court below was correct in denying to taxpayer the refund it claimed.

ARGUMENT

TAXPAYER CORPORATION FAILED TO PROVE THAT THE INCOME HERE CONCERNED RESULTED FROM OWNERSHIP AND OPERATION OF THE BUSINESS BY ANYONE OTHER THAN ITSELF

The issue of the case is to whom shall be taxed the income realized from operation of this mill business subsequent to June 30th of the taxable year. By and large, income is taxable to the person who earns or otherwise creates the right to receive it, or who is the beneficial owner of the property which produces it. See *United States v. Joliet & Chicago R. Co.*, 315 U. S. 44; *Helvering v. Eubank*, 311 U. S. 122; *Helvering v. Horst*, 311 U. S. 112; *Burnet v. Leininger*, 285 U. S. 136; *Lucas v. Earl*, 281 U. S. 111; *Daugherty v. Commissioner*, 63 F. (2d) 77 (C.C.A. 9th); *Villere v. Commissioner* (C.C.A. 5th), decided February 16, 1943 (1943 C.C.H., par. 9291); *Covington v. Commissioner*, 103 F. (2d) 201 (C.C.A. 5th); *McDonald Coal Co. v. Lewellyn*, 16 F. (2d) 274 (C.C.A. 3d); 2 Mertens, Law of Federal Income Taxation (1942), Section 18.02, Sections 17.01 *et seq.*

Taxpayer contends that it did not earn the income which the Commissioner of Internal Revenue taxed to it and that it was not the owner of the property from

which that income was derived. The taxpayer's claim is that on June 30th of 1933 it transferred all of the mill property to a partnership composed of its stockholders; and it was the partnership which operated the business during the last six months of the taxable year.

To these contentions the Government answers, as did the court below, that no valid transfer of assets was made on June 30, 1933; the alleged partnership transferee was not in existence at that time.

It is well settled that in the absence of statute a majority of the stockholders of a corporation have no power to sell and convey its entire property and discontinue its business, if the sale is not required by the exigencies of the business; there must be unanimous consent of the stockholding interests to any such sale. Neither the directors nor a majority of the shareholders of a going concern, nor both together, have power unless statutorily granted, to dispose of even so much of the corporate property as will render the company unable to continue in business. See *Des Moines Life & Annuity Co. v. Midland Ins. Co.*, 6 F. (2d) 228 (Minn.); *American Seating Co. v. Bullard*, 290 Fed. 896 (C.C.A. 6th); *Jones v. Missouri-Edison Electric Co.*, 144 Fed. 765 (C.C.A. 8th); *People v. Ballard*,

134 N.Y. 269; *Kean v. Johnson*, 9 N.J. Eq. 401; Ballantine, Manual of Corporation Law and Practice (1930), Section 59.

Examination of the statutes of the State of Washington relating to corporations fails to disclose any grant of power in corporate directors or majority stockholders to convey corporate assets in their entirety. But we have here a purported bill of sale covering all of the personal property owned by the corporation except its accounts receivable, and a deed of conveyance to all of its real property, with nothing whatsoever in the record showing that the exigencies of this business demanded the cessation of operations, or that the transfers were made under unanimous consent of the stockholding interests. The bill of sale and deed were executed pursuant to resolution by the board of trustees taken at its meeting June 30, 1933; the resolution recited that *in the opinion of the board* the corporation should go out of business. (R. 62.) The minutes of the stockholders' meeting held that same day declare that the resolution received the unanimous vote of all stock "represented." (R. 68.) There were present at the meeting only three of the fourteen shareholders, and these three comprised the board of trustees which drafted the resolution. (R. 23.) The stock "represented" was their own; no

contention is made that the stockholders present held proxies from the stockholders absent.

Nor had the "transfers" been previously approved by the absent stockholders. It is true that F. M. Roberts, one of the officer-trustees who executed the instruments on behalf of the corporation, had held some discussion with the other shareholders concerning the matter prior to the meeting where the "transfers" were executed. But the conversations admittedly did not extend beyond the *advisability* of forming a partnership to take over the assets and operate the business in order to minimize tax liability; the discussions were in the most general of terms and quite clearly did not deal at all with any details of the proposed transaction. With the possible exception of the stockholder Swan, none of the other stockholders seemingly were given opportunity to consent or indeed any information whatsoever as to the manner or means by which the stated objective was to be accomplished. (R. 21, 53-54.)[4]

It is difficult to see how under such circumstances they may be said to have consented in advance to the particular means which Carlson, Roberts, and

[4] It does not appear that Carlson's wife and two children, who were record stockholders, were even apprised of the purpose of the contemplated transfer.

Weter saw fit thereafter to adopt at a meeting which those three alone attended.[5] It seems plain that in attempting to convey away almost the whole of the corporate assets the three stockholders assumed a power which they did not have, and that their action was accordingly a nullity.

But even if these majority stockholders had power to authorize a valid transfer of the corporate assets without the consent of the others or with such "consent" as appears here, still, we submit, their attempted action was ineffective. For the stockholders' meeting was itself an invalidity. In the notice which was mailed to the stockholders, the place of meeting was described as the "mill office" (R. 59); the minutes of the meeting declare that it was held there (R. 67), but the evidence is clear that actually it took place in the law office of Weter and Roberts,

[5] For example, the amount, method of payment, and distribution of the consideration for the "sale" appears to have been decided upon at the meeting. Likewise, it was after the discussion held there that the three stockholders present determined that taxpayer should retain its accounts receivable and not include them in the "sale." (R. 62-68.) The arrangement that the deed to the real property should run to Roberts as grantee was also made at the meeting of June 30, 1933. (R. 72.) Obviously all of these things were matters of major importance in the transaction to which the consent of stockholders informed only of the objective to be accomplished cannot be assumed.

some eight miles from the mill (R. 65). It is elementary that stockholders' meetings must be held at the time and place of notice given in order to give validity to action there taken. What is done at a meeting held elsewhere than at the place stated in the notice cannot bind stockholders who are not present and who do not participate. See Ballantine, Manual of Corporation Law and Practice (1930), Sections 166, 167 and 168. We do not have here any evidence of waiver of this defect by the eleven absent stockholders, nor any consent by them to the action which was taken at the illegal meeting except again such consent as may be implied from their failure affirmatively to object and their subsequent inclusion on their individual tax returns of the company earnings during the last six months of 1933.

We direct attention, too, to the defect in the in-

Perhaps subsequent acquiescence of the stockholders to the transfer in all its details is to be implied by their acts in returning as their individual income the earnings of the business during the last six months of 1933. But these returns were presumably filed in March of the year following, and certainly they could not serve, we submit, as consents relating back to the date the instruments were executed, to prevent the Federal Government from claiming against one who in the absence of a valid transfer would clearly be taxable as the owner of the property producing the income.

strument of conveyance itself. The deed to the real estate recites as a part of the consideration therefor, assumption by the grantee of the "herinafter described mortgage" (R. 69), but as the court below pointed out (R. 24), the deed does not mention or describe any mortgage except in those terms. And as for the cash consideration stated in deed and bill of sale, there is no evidence whatsoever to show that the "transferee" paid it or any part of it, except the recitations of the instruments themselves. (R. 69, 73.) The court below was well advised it would seem in describing the transaction as not an "actual sale" but "at most merely a liquidating dividend." (R. 31.)

Even the transferee was chimerical; the purported partnership simply was not then in existence. True, the transfers run to a "partnership," but it takes something more than the empty use of words to create that status. For income tax purposes, a partnership exists or does not exist; it is not to be "created." A taxpayer does not escape liability by conjuring up another taxpayer. See 6 Mertens, Law of Federal Income Taxation (1942), Sections 35.04, 36.08. And the revenue law prescribes its own tests for the existence of a partnership; local law is not controlling. *Wholesalers Adjustment Co. v. Commis-*

sioner, 88 F. (2d) 156 (C.C.A. 8th); *George Brothers & Co., v. Commissioner*, 41 B.T.A. 287; 6 Mertens, Law of Federal Income Taxation (1942), Section 35.02.

In its essence, the formation of a partnership is, of course, a matter of contract law; the minds of the contracting parties must meet. There is no showing that they had met here at the time the purported transfer was made to the alleged partnership; the evidence is that they had not. Clearly the partnership was *in futuro* on June 15th, the mailing date of the notice of the coming stockholders' meeting. That notice stated (R. 22) as the purpose of the meeting, "to pass upon the question of the sale of the assets of the corporation to a partnership *to be formed* to take over the same." (Italicts supplied.) As with the proposed transfer, so with the proposed formation of a partnership, the only thing which the minds of the parties were in agreement upon prior to the meeting date was the *advisability* of such action. Manifestly a partnership is not formed on agreement as to its advisability. And it would seem that the partnership was still *in futuro* on June 30th,, the date of the transfers. The resolution of the trustees taken that day states as follows (R. 63):

> Resolved that the Seattle-Renton Lumber Company sell to a partnership, which *will be composed* of the same persons who have held stock in the Seattle-Renton Lumber Company and which *will be known* as the Seattle-Renton Mill Company, * * *. (Italics supplied.)

Since the bill of sale executed the day this resolution was passed runs now to "Seattle-Renton Mill Co., a partnership" (R. 73), and Roberts' declaration of trust in the real property also made that same day describes the beneficiaries named therein as "partners" (R. 78), seemingly formation of the partnership took place in the time interval between passage of the aforementioned resolution and the execution of the instruments of transfer. Yet it is acknowledged that only Weter, Roberts, and Carlson were present at the Weter and Roberts law office where the trustees' and stockholders' meetings were held, and it is not contended that anyone besides these three participated in any of the action there taken. It is therefore difficult to see how the partnership, *in futuro* when the the resolution was passed, was a partnership *in esse* when the instruments were executed. Certainly the three participants at the meeting could not summarily establish a partnership, make co-partners of the eleven nonparticipants, and determine their respective partnership rights and obligations solely on the basis of the previous approval given to the pur-

pose of the proposed conversion of the business to partnership form. But we must accept this conclusion, we submit, if we are to give credence to taxpayer's contention that a partnership existed when the transfers were made.

The plain fact of the matter is that the so-called partnership was a mere sham; its formation nothing but a gesture. The "conversion" from corporation to partnership had no business purpose whatsoever; it was a tax-avoidance device pure and simple.. As taxpayer urges, there is nothing illegal or reprehensible in a taxpayer's endeavor legitimately to avoid or minimize his tax liability. *Superior Oil Co. vs. Mississippi*, 280 U. S. 390; *United States v. Isham*, 17 Wall. 496; *Jones v. Helvering*, 71 F. (2d) 214 (App. D.C.). The method used will be recognized if it is legally effected. See *Commissioner v. Falcon Co.*, 127 F. (2d) 277 (C.C.A. 5th); *Chisholm v. Commissioner*, 79 F. (2d) 14 (C.C.A. 2d). Cf. *Higgins v. Smith*, 308 U.S. 473; *Griffiths v. Commissioner*, 308 U.S. 355. Arrangements made without purpose other than minimization of tax liability are subject, however, to the most careful scrutinies, and they will be approved only when it is shown beyond any doubt that the purpose has in fact been legally accomplished. The material fact is what is actually done, and substance

governs over form. *Gregory v. Helvering*, 293 U.S. 465; *Thompson v. United States*, 110 F. (2d) 585 (C.C.A. 5th); *First Nat. Bank of Greeley, Colo. v. United States*, 86 F. (2d) 938 (C.C.A. 10th); *S. A. MacQueen Co. v. Commissioner*, 67 F. (2d) 857 (C.C.A. 3d), affirming 26 B.T.A. 1337; *United States v. Jelenko*, 23 F. (2d) 511 (Md.); *Jackson v. Commissioner*, 39 B.T.A. 937; *Mackay v. Commissioner*, 29 B.T.A. 1090; 2 Mertens, Law of Federal Income Taxation (1942), Section 17.06.

In the *Gregory* case, the Supreme Court, striking down a purported reorganization motivated solely to enable the taxpayer to escape taxation on the sale of certain stock,[6] expressed the proposition thus (pp. 468-469):

> It is earnestly contended on behalf of the taxpayer that since every element required by the foregoing subdivision (B) is to be found in what was done, a statutory reorganization was effect-

[6] The courts have similarly struck down "dummy" corporations erected for tax avoidance purposes; refused to recognize a transfer of assets by a corporation to an individual prior to an ultimate sale to a third person, when the transfer was motivated solely by desire to avoid taxation; denied that a taxpayer may avoid a tax upon income by assigning the right to receive it. See 2 Mertens, Law of Federal Income Taxation (1942), Sections 17.05, 17.06, 18.02, and cases therein cited.

> ed, and that the motive of the taxpayer thereby to escape payment of a tax will not alter the result or make unlawful what the statute allows. It is quite true that *if a reorganization in reality was effected within the meaning of the subdivision (B)*, the ulterior purpose mentioned will be disregarded. The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted. [Citing authority.] But the question for determination is whether what was done, apart from the tax motive, was the thing which the statute intended. (Italics supplied.)

So here, the question for determination is whether a partnership in reality was formed, and the assets of the business actually transferred.

To be sure, subsequent to the date of the transfers to the partnership which taxpayer claims was *then* in existence, certain action was taken in an effort to make it appear that the business had been converted from corporate to partnership organization. Thus, "books" were opened for the new partnership, but they were carried in the same binders as those of the corporation, and some of the accounts were apparently indexed together. (R. 111-112.) A bank account was opened for the "partnership," but it appears that an order of check forms which was erroneously printed with blanks for signature by president and

secretary was not returned for reprint, but was used. (R. 25.) Signs and stationery were changed by ink or stamp so that the word "Lumber" in the company title now read "Mill," but there was no indication whether the new name designated a corporation or partnership. (R. 25.) When inquiry was made by the mill customers as to why the name had been changed, they were told that the concern had become a partnership; but they were given neither the names of the co-partners nor any other details of the "conversion." (R. 25.) There was no published notice of the formation of a partnership, nor was any affirmative attempt made to give creditors and customers of the mill notice of the change. (R. 25.) No certificate of assumed business name was filed. (R. 25.) And all of the instruments of transfer were retained by Roberts; the deed to the real estate alone was placed of record, and that was done only after the Commissioner had raised the issue of the *bona fides* of this transfer and the existence of this partnership. (R. 24.)

There were no written articles of partnership (R. 25), and there is nothing in the evidence showing any oral understanding between the "co-partners" as to their respective rights and duties. Seemingly none of the "partners" contributed their services to

the business, except Carlson; and he "contributed" his services as manager at practically the same salary he had been receiving from the corporation. There were no contributions of capital except insofar as the stockholders may have left in the business their proportionate shares of the liquidating dividend. Cf. *Meehan v. Valentine*, 145 U.S. 611; *Earp v. Jones*, 131 F. (2d) 292 (C.C.A. 10th); *Commissioner v. Tenney*, 120 F. (2d) 421 (C.C.A. 1st); *Black v. Commissioner*, 39 B.T.A. 1068.

There does not appear to have been any agreement among the "partners" to share in the losses of the business, and under the evidence hereinbefore outlined, it may well be questioned, as the court below did (R. 32), whether any of the alleged partners except Weter, Roberts, Carlson, and possibly Shinstrom, could be held to partnership liability. However this may be, we are not dealing here with any doctrine of estoppel; again, for income tax purposes a partnership exists or does not exist. *Robertson v. Commissioner*, 20 B.T.A. 112; *Fouke v. Commissioner*, 2 B.T.A. 219. And see *Niles Fire Brick Co. v. Commissioner*, 6 B.T.A. 8 (involving a purported change from partnership to corporate form). See also 6 Mertens, Law of Federal Income Taxation (1942), Section 35.04.

We submit that there was no partnership in existence here. See *Covington v. Commissioner, supra; Hinz & Landt, Inc., of Los Angeles v. Commissioner*, 8 B.T.A. 375; *Rice-Sturtevant Automobile Co. v. Commissioner*, 6 B.T.A. 793; *Citizens Loan Association v. Commissioner*, 1 B.T.A. 518. Cf. *Royal Wet Wash Laundry v. Commissioner*, 14 B.T.A. 470.[7] The evidence is clear that it was taxpayer corporation which operated this business during the last six months of 1933, in substance if not in form; and it was taxpayer corporation which was in reality the beneficial owner of the assets which produced the income here in question. It is the corporation, therefore, which is liable for the tax; the fruits may not be attributed to a different tree from that on which they grew. *Lucas v. Earl, supra.*

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[7] This case, upon which taxpayer places such reliance in its brief (pp. 31-33), is readily distinguishable from the one at bar. There, formal articles of partnership were executed on the date it was contended that the partnership took over the business. A valid transfer of assets was made on that date; only the formal evidence of the transfer, the bill of sale, was lacking. Furthermore, the stockholders who were not present at the meeting where this business was transacted signed the minutes expressly approving the sale to the partnership.

CONCLUSION

For the reasons foregoing, we believe that the judgment of the District Court is entitled to affirmance.

Respectfully submitted,

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